

## Internal Revenue Service

Department of the Treasury  
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Third Party Communication: None  
Date of Communication: Not Applicable  
Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B05

PLR-145670-11

Date:

January 11, 2012

### Legend:

Distributing =

Controlled =

State A =

Year 1 =

Date 1 =

Date 2 =

Business A =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

a =

b =

c =

d =

Dear :

This letter responds to your October 27, 2011 request for rulings on certain Federal income tax consequences of the Proposed Transaction (defined below). The information provided in that request and in later correspondence is summarized below.

### **Summary of Facts**

Distributing is a closely-held State A corporation that was incorporated in Year 1 and elected to be treated as an S corporation on Date 1. Distributing is engaged in various businesses through its wholly owned subsidiaries. The financial information submitted by Distributing indicates that several of its businesses had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The stock of Distributing is held by Shareholder 1, Shareholder 2, Shareholder 3, and Shareholder 4, in the following percentages respectively: a%, b%, c%, and d%. Distributing is a calendar-year, accrual-method taxpayer.

On Date 2, a wholly-owned subsidiary of Distributing merged with and into Controlled with Controlled becoming the surviving entity. Controlled elected to be treated as a qualified subchapter S subsidiary ("QSub") effective Date 1. Controlled is engaged in Business A. The financial information submitted by Distributing indicates that that Business A, as conducted by Controlled, had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Distributing desires to distribute all the stock of Controlled as the business activities of Controlled are different from the other wholly-owned subsidiaries of Distributing and management believes that Controlled's business will be able to operate more efficiently and more effectively without being associated with the remaining businesses operated by Distributing.

### **Proposed Transaction**

For what is represented to be a valid business purpose, Distributing has proposed the following transaction (the "Proposed Transaction"), which is to occur in the following order:

- (i) Distributing will distribute all the shares of Controlled stock to Distributing's shareholders pro rata on one day.
- (ii) Controlled will elect, and Distributing will maintain, S corporation status for Federal and state tax purposes.

There are no planned transactions with respect to the stock of either Distributing or Controlled after the distribution. After the distribution, the same shareholders will own both Distributing and Controlled and will have the same relative ownership in each corporation.

### **Representations**

Distributing has made the following representations with respect to the Proposed Transaction:

- (a) No part of the Controlled stock to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Controlled and the other businesses operated by Distributing are representative of each corporation's present operations and with regard to such corporations there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Following the Proposed Transaction, Controlled and Distributing (through its subsidiaries) will each continue the active conduct of its business, independently and with its separate employees or the employees of its affiliate.
- (d) The distribution of the stock of Controlled (the "Distribution") is carried out for the following corporate business purposes: (1) To separate the business of Controlled and the retained businesses of Distributing in order to enable each business to concentrate the attention of its management and financial resources on its core business; and (2) to reduce the potential risk of litigation and the costs, including administrative costs, imposed on Distributing's retained businesses as a result of the regulatory requirements associated with the mortgage business. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (e) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both.
- (f) No intercompany debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, because all intercompany debt, if any, will be paid

prior to the distribution. No indebtedness has been or will be cancelled in connection with the Proposed Transaction.

(g) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(h) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).

(i) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent of more of the total combined voting power of classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

(j) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent of more of the total combined voting power of classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was acquired by purchase (as defined in sections 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

(k) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. 1.355-7), pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4) in Distributing or Controlled (including a predecessor or successor of such corporation).

(l) Neither the business conducted by Distributing nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized or treated as recognized in whole or in part.

(m) The total adjusted basis and the total fair market value of the assets to be transferred by Distributing to Controlled, in the deemed formation contribution transaction (the "Contribution") will exceed the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in the Contribution.

(n) The total fair market value of the assets of Controlled will exceed the amount of its respective liability immediately after the Contribution.

- (o) The liabilities to be assumed (within the meaning of section 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (p) The aggregate fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the aggregate adjusted basis of such assets.
- (q) Immediately after the Proposed Transaction (as defined in section 355(g)(4)), neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).
- (r) Distributing, Controlled, and their respective shareholders will pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- (s) Effective on Date 1, Distributing made an election under section 1362(a) to be an S corporation (within the meaning of section 1361(a)), and Distributing has continued to be an S corporation since Date 1.
- (t) Immediately after the Distribution, Controlled will be eligible to elect S corporation status pursuant to section 1362(a).
- (u) Controlled will elect to be treated as an S corporation effective immediately after the Distribution.
- (v) None of the persons holding stock or any equity interest in Distributing or Controlled is a nonresident alien individual, a foreign corporation, or a trust.
- (w) There is no plan or intention to revoke or otherwise terminate the S corporation election of Distributing or Controlled.
- (x) No property deemed transferred between Distributing and Controlled has, or will, claim investment credit under section 46.
- (y) Distributing and Controlled each use the accrual method of accounting.

### **Rulings**

Based solely on the information submitted and the representations set forth above, we rule as follows on the Proposed Transaction:

- (1) The distribution of the stock of Controlled (the "Distribution") will cause a termination of Controlled's election to be a QSub because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For Federal income tax purposes, the

Distribution will be treated as if Controlled is a new corporation acquiring all of its assets (and assuming all of its liabilities) in a deemed contribution (the "Contribution") from Distributing occurring immediately before the Distribution, and Distributing will be deemed to receive the stock of Controlled in exchange for the Contribution (§ 1.1361-5(b)(1)(i)).

(2) The Contribution followed by the Distribution will be a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of section 368(b).

(3) No gain or loss will be recognized by Distributing on the Contribution (sections 361(a) and 357(a)).

(4) No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).

(5) The basis of each asset deemed received by Controlled in the Contribution will be equal to the basis of such asset in the hands of Distributing immediately before its transfer (section 362(b)).

(6) The holding period for each asset deemed received by Controlled in the Contribution will include the period during which such asset was held by Distributing (section 1223(2)).

(7) No gain or loss will be recognized by Distributing on the Distribution (section 361(c)).

(8) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholders 1 through 4 upon their receipt of Controlled stock (section 355(a)(1)).

(9) The basis of the Distributing stock and the Controlled stock in the hands of each of Shareholders 1 through 4 immediately after the Distribution will equal the respective shareholder's basis in the Distributing stock held immediately before the Distribution. Such basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (sections 358(b) and (c)).

(10) The holding period of the Controlled stock received by Shareholders 1 through 4 in the Distribution will include the holding period of the Distributing stock with respect to which it is received, provided that the Distributing stock is held as a capital asset in the hands of the respective shareholder on the date of the exchange (section 1223(1)).

(11) As provided in section 312(h) of the Code, proper allocation of earnings and profits between Distributing and Controlled will be made under § 1.312-10(a).

(12) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which earnings and profits of Distributing will be allocated under section 312(h) in accordance with § 1.1368-2(d)(3).

(13) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be able to make a subchapter S election under section 1362(a) for its first taxable year, provided such election is made effective immediately following the termination of the original QSub election.

### **Caveats**

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express no opinion regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled (see section 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see section 355(e) and § 1.355-7). Furthermore, no opinion is expressed as to the validity of any S corporation election or QSub election of Distributing or Controlled.

### **Procedural Statements**

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Isaac W. Zimbalist  
Isaac W. Zimbalist  
Senior Technician Reviewer, Branch 5  
Office of Associate Chief Counsel  
(Corporate)

cc: